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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume III No. 7 December 16, 1980

FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. Gross activity by foreign investors in U.S. equities accelerated in the third quarter to $19.5 billion, surpassing the record first quarter pace of $18.4 billion. For the first three quarters of 1980, gross activity by foreigners in U.S. equities totaled $50.4 billion. In comparison, total gross activity was $37.9 billion and $43.5 billion for all of 1978 and 1979, respectively. Gross activity for 1980 may almost double the level reached just two years earlier.

2. Net foreign purchases of $713 million represented a 75% increase from the second quarter level. This increase was not based on a general renewal of confidence in the U.S. by all other nations but rather on substantial purchases from the oil-exporting countries. These nations accounted for over 98% of total net purchases by all foreign investors during the third quarter.

3. Net purchases of equities by the Asian countries soared to $693 million from net sales of $31 million in the second quarter. This increase was due mainly to purchases of $702 million by the oil-exporting countries.

4. Net foreign purchases of U.S. corporate bonds dropped to $836 million from $1.1 billion in the second quarter, while gross activity declined to $2.2 billion from $2.9 billion. Despite an uptick of rates, most foreign investors evidenced a reluctance to make long-term commitments in what is proving to be a very volatile market.

5. For the first three quarters of 1980, net purchases of foreign equities by U.S. investors amounted to $1.9 billion, or double the 1979 total of $993 million, which was the record high for the 1970-79 period. In the third quarter, U.S. purchases of foreign stocks increased about 88% to $801 million.

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INTRODUCTION

Foreign investors assess a host of economic and political variables before investing in U.S. equities. Foremost among these variables is the relative strength or weakness of the dollar. In the third-quarter, the dollar made a modest recovery from its sharp second-quarter depreciation against all major currencies. Moreover, economic news began to signal the end of the recession. However, foreign investors with the exception of the oil-exporting countries showed a hesitancy in their purchases of U.S. securities.

The inching up of the leading economic indicators over the summer months began to mitigate fears of a deep and prolonged recession in the U.S. The preliminary real GNP figure indicated a 1.0% annual rate of increase in the third quarter, a far cry from the steep second-quarter plunge of 9.6%. However, the persistence of inflationary pressures and the quick resumption of the upward path of interest rates continued to undermine the economy. The outbreak of war between Iran and Iraq and the mounting speculation over the outcome of the Presidential race were other uncertainties marking the third quarter.

Just as doubts about the recovery from the U.S. recession were emerging, many European countries were in the full-throes of an economic downturn. Moreover, the deterioration of the current account positions of many European countries was aggravated by the relative firmness of the dollar which increased the cost of oil in terms of other currencies. In contrast, the U.S. current account is projected at a surplus or near-surplus for the year. Trade fundamentals were one of the main factors bolstering the dollar in the third quarter. Europe's problems were also exacerbated by restrictive U.S. monetary policies forcing central bankers to maintain high interest rates and tight money policies to avoid further exchange rate drops, higher real oil prices, and imported inflation.1/

1/ "The global barriers to recovery," Business Week, September 15, 1980, p.36

On a quarterly basis, the annualized rates of change in consumer prices are indicative of the effect of the worldwide economic slowdown. The U.S. inflation rate dropped from 13.0% to 6.6%, West Germany from 6.2% to 1.1%, the U.K. from 21.4% to 6.8%, and Canada from 11.7% to 10.4%. 2/ However, the September year-to-year change shows inflation in these countries, with the exception of West Germany, still running at double-digit rates.

The effective trade-weighted dollar was steady over the third quarter, rising to 96.7 by end-September from 96.2 at end-June. 3/ Based on closing month-end exchange rates, the dollar appreciated against four major currencies, the most significant being 2.8% against the German mark and 2.5% against the French franc. Depreciation vis-à-vis only two major currencies was recorded over the period, a 4.3% drop against the yen and a more moderate 1.1% decline against sterling.

During the third quarter, market performance indices continued on an uptick. The NYSE Composite, the DJI, and the S&P 500 rose 10.8%, 6.4%, and 9.8%, respectively. The most pronounced monthly gains were made in the June-July period. For the remainder of the quarter, minimal gains were posted by the NYSE Composite and the S&P 500 while the DJI fell slightly.

Foreign Activity in U.S. Equities

Quarterly Gross Activity

Gross activity in the third quarter accelerated to $19.5 billion, surpassing the record first-quarter pace of $18.4 billion. For the first three quarters of 1980, gross activity by foreigners in U.S. equities totaled $50.4 billion. In comparison, total gross activity was $37.9 billion and $43.5 billion for all of 1978 and 1979, respectively. Therefore, gross activity for the entire year may double the level reached just two years earlier. Gross activity rose in all geographic regions from the second to third quarters. Interestingly, the Mid-east oil-exporting nations were particularly active in the U.S. securities markets as their activity was almost double that of the first quarter.

2/ Based on Consumer Price series of Business Conditions Digest, U.S. Department of Commerce, Bureau of Economic Analysis, October 1980, p.95

3/ Based on World Financial Markets data, Morgan Guaranty Trust Company, October 1980, p.12

TABLE I

GROSS ACTIVITY IN U.S. EQUITIES
($ Millions)

	1980 First Quarter	1980 Second Quarter	1980 Third Quarter
Europe	$11,509	$ 7,223	$11,921
Belgium-Luxembourg	367	254	432
France	1,263	691	1,298
Germany	1,376	625	1,395
Netherlands	486	416	570
Switzerland	4,603	2,597	4,572
United Kingdom	2,983	2,363	3,243
Canada	2,898	1,988	2,882
Latin America	1,706	1,429	1,711
Bermuda	650	606	673
Netherlands Antilles	449	412	397
Asia	2,177	1,836	2,868
Hong Kong	500	285	550
Japan	589	469	446
"Other Asia"*	962	1,014	1,744
Total All Countries	$18,372	$12,539	$19,507

SOURCE: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Arab Emirates.

Quarterly Net Activity

While gross activity hit a record level in the third quarter, net purchases of $713 million came to no where near the first quarter record high of $2.1 billion. Nevertheless, the third quarter figure represents a 75% increase from the $408 million recorded in the second quarter. This increase, however, was not based on a general renewal of confidence in the U.S. by all other nations but rather on the substantial purchases of the oil-exporting countries, who accounted for over a startling 98% of total net purchases by all foreign investors.

Clearly, U.S. equities have once again gained favor with Mid-east investors. In fact, their net purchases through the first three quarters exceeds the totals for 1978 and 1979, and may approach the lofty heights reached in 1975 and 1976 averaging about $1.7 billion. If so, this represents an important reversal for these investors whose interest in U.S. stocks has been waning since 1976.

Net purchases by European countries at $65 million dropped over 80% from the second-quarter level, while Latin American countries made unusually large net sales of $139 million. Canadian investors increased net purchases by 50% to $72 million, which is still low compared with the quarterly averages of $141 million in 1979 and $168 million for the first half of 1980.

On a monthly basis, all major regions with the exception of Asia were net sellers of U.S. equities in September. While the strength of the U.S. recovery was always in question during the summer months, both interest rates and the CPI posted their largest monthly gains of the quarter in September. By late in the month, mortgage rates had moved beyond 14% and the prime lending rate had escalated to 14%. With sharp increases in interest rates and the disturbing uptick of inflation putting the U.S. economic recovery in further jeopardy, foreign investors stepped back to reassess investment in U.S. securities.

TABLE II

NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1980 First Quarter	1980 Second Quarter	1980 Third Quarter
Europe	$1,475	$ 352	$ 65
Belgium-Luxembourg	(25)	33	(28)
France	155	46	60
Germany	62	12	(49)
Netherlands	(38)	(95)	(92)
Switzerland	493	(111)	(332)
United Kingdom	783	460	545
Canada	288	48	72
Latin America	80	29	(139)
Bermuda	(26)	2	14
Netherlands Antilles	39	21	(145)
Asia	257	(31)	693
Hong Kong	78	11	58
Japan	15	(76)	(66)
"Other Asia"*	162	44	702
Total All Countries	$2,100	$ 408	$ 713

SOURCE: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Emirates.

European Investors

Net purchases by European countries tumbled from $352 million in the second quarter to $65 million. With the exception of the United Kingdom and France, all major European countries were net sellers of U.S. equities. On a monthly basis, net purchases declined from $118 million in July to $30 million in August. In September, only the United Kingdom was a net purchaser and total Europe posted net sales of $83 million.

The level of net purchases by total Europe has been upheld chiefly by the continued interest of British investors. Net purchases by the United Kingdom picked up 18% from $460 million in the second quarter to $545 million, which represents the second highest quarterly figure in 1979 and 1980. The British economy has been struggling with double-digit inflation and a recession well-before the other major world economies. A combination of tight monetary policy, high interest rates and a strong pound have taken their toll on British corporate profits and dividends. On the other hand, the lifting of British exchange controls, the paradoxical strength of the pound, and comparably more favorable outlooks for the other major industrial economies have made the time opportune for British diversification into foreign investments. Indeed, net investment of British financial institutions in foreign company securities in the first quarter of 1980 was over 4 times the level for the same period in 1979 and 38% more than their investment in British companies. Second quarter figures show this interest being maintained, although slightly lower than the first quarter.4/

While it is not unusual for Swiss investors to be net sellers of U.S. equities, the net sales of $332 million posted in the third quarter are the largest quarterly sales recorded in 1979 and 1980 and 3 times the previous quarter's level of $111 million. Over the past two quarters, pressures on the franc have eased and it has been relatively steady. In addition, the Swiss economy has not been as adversely affected as the other major industrial countries by recessionary pressures. Exports have picked up, domestic investment and consumer demand have increased, and the Swiss economy is at full employment. The Swiss central bank has been quick to react to inflationary pressures, keeping interest rates high enough to provide a real rate of return.5/

Although the French increased net purchases by 30% to $60 million in the third quarter, in September they were net sellers of $32 million of equities. German investors made net sales of $49 million in the third quarter, with net sales recorded in every month of the quarter.

4/ "Overseas gluttons," The Economist, 10/11/80, p. 93

5/ "The Swiss Franc Prepares to Rise Again," Euromoney, October 1980, p. 166

Canadian Investors

Net purchases by Canadian investors rose to $72 million from $48 million in the second quarter. However, the level of net purchases in both the second and third quarters are distinctly lower than previous levels. Canadian investors seem to be losing their enthusiasm for U.S. securities. On the other hand, after evidencing strong interest in Canadian natural resource stocks in recent quarters, U.S. investors were net purchasers of Canadian securities only in September, albeit at a significant $277 million.

Asian Investors

Net purchases by Asian countries soared to $693 million from net sales of $31 million in the second quarter, accounting for 97% of the total purchases of all countries. This dramatic increase was based on substantial purchases by the oil-exporting countries, particularly in September when net purchases hit $411 million. In fact, of the four major geographical regions, only Asia was a net purchaser in September.

Net purchases of $702 million of U.S. equities in the third quarter by the oil-exporting countries are about 16 times the second quarter level of $44 million. In comparison, total net purchases in 1978 and 1979 were $781 million and $656 million, respectively. Despite contradictory reports of heavy diversification out of dollar denominated assets, especially since the freezing of Iranian assets in the U.S., the oil-exporting countries are showing renewed interest in U.S. equities.

Foreign Activity in U.S. Treasury Notes & Bonds

During the third quarter, all U.S. interest rates moved decisively upward after reaching a low point in June. While yields on long-term government bonds increased about 200 basis points during the period, yields on Treasury bills escalated over 300 basis points. Confirming the buildup of credit demand, the Federal Reserve raised the discount rate to 11% from 10% in late September. As interest rate differentials among countries began to favor dollar-denominated assets, pressures on the major European currencies developed. Third quarter net sales of $463 million of Treasuries by European countries reflect primarily the intervention of central banks to moderate currency fluctuations. Asian countries reduced purchases by 57%, based mainly on a 45% reduction in net purchases by the oil-exporting countries. However, holding of Treasuries by international and regional agencies (not shown in Table III) increased by $299 million, offsetting European net sales and reduced purchases by Asia. Total foreign holdings of Treasuries rose by $1.7 billion, or 3.5%, to $49.5 billion in the third quarter.

Net sales by European countries of Treasuries over the third quarter represents a doubling of the second quarter level of $232 million. Substantial sales of $986 million were recorded for Germany, an increase of over 90% from the second quarter level. The German mark weakened considerably over the quarter as estimates of Germany's current account deficit continue to be revised upward. Despite slowing GNP growth, the Bundesbank has tried to maintain relatively high interest rates to prevent any further strain on the mark. While the Swiss franc was relatively free from pressure compared to the first and second quarter of this year, the franc depreciated modestly against the dollar in the third quarter. Consequently, the Swiss made net sales of $165 million of U.S. Treasuries to support the franc, in contrast to net purchases of $197 million in the second quarter.

Offsetting the net sales of these two countries were the substantial purchases of $472 million of Treasuries by the United Kingdom, most notably in September when net purchases totaled $367 million. Sterling has enjoyed a strong foreign exchange position, bolstered in part by the controversial high interest rate policy of the central bank. However, real interest rates shifted in favor of the dollar and were at the widest point in September. The interest rate differential was most likely responsible for the 58% increase in United Kingdom Treasury holdings.

Asian countries reduced net purchases by 36% to $1.5 billion from $2.4 billion in the second quarter. Responsible for much of the downtread were the oil-exporting countries, which cut net purchases back to $1.4 billion from an exceptionally high quarterly average of $2.3 billion in the first half of 1980. On the other hand, net purchases of U.S. equities were significantly increased by the oil-exporting countries in the third quarter.

TABLE III

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS
OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1980 Second Quarter		1980 Third Quarter	
	Net Purchases	Holdings	Net Purchases	Holdings
Europe	$ (232)	$19,059	$ (463)	$18,596
Switzerland	197	528	(165)	363
Germany	(513)	8,861	(986)	7,875
United Kingdom	8	7,001	472	7,473
Asia	2,361	22,751	1,501	24,252
Japan	(85)	9,545	(101)	9,444
"Other Asia"	2,508	12,729	1,384	14,113
All Countries	$ 136	$47,813	$ 1,676	$49,489

SOURCE: U.S. Treasury

Foreign Activity in U.S. Corporate Bonds

Over the third quarter, long-term corporate bond yields in the U.S. resumed an upward course, climbing from about 10.63% at end-June to almost 13% by end-September. The rise in long-term yields was impelled by investor concerns that an economic recovery was beginning even before there had been any significant letup in inflationary pressures.6/ Corporate issuers pulled back from the long-term market, with new issues in the third quarter averaging $4.5 billion per month -- more than $2 billion below the second quarter's monthly average. Much of the exceptionally high level of activity in corporate bonds in the second quarter resulted from an attempt by foreign investors to capture the attractive yields available early in April. As yields drifted down over the quarter, so too did the level of foreign activity. Therefore, it is not unusual that third-quarter activity subsided from the previous quarter's pace. Despite an uptick of rates, most foreign investors evidenced a reluctance to make long-term commitments in what is proving to be a very volatile market.

Both net purchases of and gross activity in U.S. corporate bonds declined by about 26% in the third quarter from the second quarter level. Net purchases dropped to $836 million, while gross activity declined to $2.2 billion. Similar to the pattern found in equity investments in the third quarter, net purchases by the oil-exporting countries accounted for a significant portion of total purchases, 86%, and the interest of U.K. investors moderated the net selling of the other major European countries.

Net purchases by European countries declined 91% in the third quarter to $29 million from $326 million. Three of the four European countries analyzed were net sellers. The most dramatic turnaround was made by German investors, who became net sellers of $60 million of corporate bonds after making large net purchases of $197 million in the second quarter. Also making a significant swing, the Swiss sold $22 million compared with net purchases of $89 million in the previous quarter. However, substantial net purchases of $100 million by the U.K. offset the net selling. The U.K. investment pattern can also be termed a turnaround, as net sales of $10 million of corporate bonds were made in the second quarter.

Net purchases by the oil-exporting countries were maintained at about the second quarter level, $716 million in the third quarter compared with $665 million. Net purchases by the oil-exporting countries have accounted for about three-fourths of foreign investment in corporate bonds since the fourth quarter of 1979. Because of the withholding tax on interest and dividend revenues received by private foreign individuals, many of these purchases were probably made by foreign government bodies.

6/ "The financial markets...current developments," Quarterly Review, Federal Reserve Bank of New York, Autumn 1980, p.13

TABLE IV

GROSS ACTIVITY AND NET PURCHASES IN U.S. CORPORATE BONDS
($ Millions)

	1980 Second Quarter		1980 Third Quarter	
	Net Purchases	Gross	Net Purchases	Gross
Europe	$ 326	$1,364	$ 29	$ 841
Belgium-Luxembourg	(6)	118	(22)	66
Germany	197	395	(60)	170
Switzerland	89	157	(22)	108
United Kingdom	(10)	518	100	394
"Other Asia"	665	993	716	892
Total All Countries	$1,123	$2,929	$ 836	$2,170

SOURCE: U.S. Treasury

U.S. Investors Activity in Foreign Stocks

In the third quarter, gross activity of U.S. investors in foreign stocks increased about 50% to $4.7 billion from the second quarter and was a shade below the high pace of the first quarter. At $12.6 billion for the first three quarters of 1980, gross activity is already 25% above the full year 1979 total of $10.0 billion and 85% above the 1978 total of $6.8 billion.

Net purchases of foreign equities for the first three quarters amounted to $1.9 billion, or double the 1979 total of $993 million, which was the record-high for the 1970-79 period. In the third quarter, U.S. purchases of foreign stocks increased about 88% to $801 million. The trend toward increased porfolio diversification into international investments has been fostered in part by the rapid growth in relative prices of foreign stock markets. In addition, in 1978 foreign investment of ERISA funds was approved, thus eliminating regulatory obstacles to institutional interest.

TABLE V

GROSS ACTIVITY IN FOREIGN STOCKS
BY U.S. INVESTORS
($ Millions)

	1980 First Quarter	1980 Second Quarter	1980 Third Quarter
Europe	$ 1,829	$ 1,009	$ 1,636
France	294	165	248
Netherlands	161	73	70
Switzerland	442	210	410
United Kingdom	650	445	716
Canada	2,099	1,291	1,703
Asia	663	597	969
Japan	512	524	799
Other	914	216	355
All Countries	$ 4,842	$ 3,113	$ 4,663

SOURCE: U.S. Treasury

U.S. interest in stocks of companies located in Europe increased 8 times to $102 million from the second quarter level of $11 million. The most significant turnabout were net purchases of $38 million of securities of companies located in the U.K. However, this quarterly figure is based on large net purchases of $56 million in July only. In subsequent months, net sales were recorded, which is consistent with quarterly monthly figures over 1979 and the first half of 1980. Also of note, net purchases of French securities picked up 2.2 times to $48 million from $15 million in the second quarter. The French franc did not depreciate as sharply as the German mark against the dollar over the quarter. And, while the French economy has many of the problems common to the European countries, fixed investment has been a leading source of growth, and it is generally believed that government investment will be maintained to prevent any serious slowdown.7/

In the first two quarters of 1979, U.S. interest in Canadian securities averaged $38 million quarterly. With the OPEC oil price increases, the U.S. appetite for Canada's natural resource stocks shot up to a quarterly average of $385 million over the next four quarters. Although this interest is still substantial, it appears to be waning. Second and third quarter purchases were $217 million and $275 million, respectively. On a monthly basis, net sales of $1 million were recorded in July and August. The third quarter figure is based solely on substantial purchases of $277 million in September. Despite a resource-rich economy, Canada is wrestling with political and economic problems that have been growing in intensity over the second and third quarters. On the political front, there were building rumors of government regulation of both domestic and foreign companies. In addition, the health of the Canadian economy is closely tied to the U.S. economy which may falter as interest rates soar.

U.S. investors continue to evidence a growing interest in Japanese securities. Net purchases jumped from $170 million in the second quarter to $421 million in the third quarter. Encouraged by a gradual improvement in Japan's current account and buoyant company profits, institutions in Europe and the U.S. have added to the flow of petrodollars into Japan. Net foreign investment in Japanese shares hit a record $1.1 billion in September.

7/ The 1981 International Economic Outlook, Goldman Sachs, 8/6/80, p. 8

TABLE VI

NET PURCHASES OF FOREIGN STOCKS
BY U.S. INVESTORS
($ Millions)

	1980 First Quarter	1980 Second Quarter	1980 Third Quarter
Europe	$129	$ 11	$102
France	106	15	48
Netherlands	113	19	8
Switzerland	(34)	14	16
United Kingdom	(10)	(45)	38
Canada	461	217	275
Asia	49	175	427
Japan	20	170	421
Other	68	24	(3)
All Countries	$658	$427	$801

SOURCE: U.S. Treasury

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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume III No. 8 January 19, 1981

FOREIGN PARTICIPATION IN THE U.S. EQUITIES MARKETS

October - November

Overview

Due to the mixture of economic news, the modest uptick of the dollar was not enough to elicit any enthusiasm from foreign investors for U.S. equities in the third quarter. While total net purchases rose by almost 75% to $713 million from the second-quarter level of $408, this increase was based almost solely on substantial purchases made by the oil-exporting countries. However, the release of third-quarter GNP data confirmed that the U.S. economy was in a recovery phase. Accompanying the recovery have been a buildup of the demand for money and credit and subsequent attempts by the Federal Reserve to constrain the growth of the monetary aggregates. These pressures caused a rapid acceleration in the climb of interest rates from end-September through November. European countries, on the other hand, were still mired in recession and could not match the rise of U.S. interest rates lest any recovery be blunted. Thus, with the U.S. economy at least out of the recession and interest rates once again at significantly high levels, foreign interest in U.S. equities picked up. In October, gross activity rose 21% from September's level and net purchases more than doubled to $518 million from $240 million.

Market Performance

In October, the NYSE Composite ticked up a modest 1.6% from the September level while the DJI Average declined by less than 1% to close at 924.49. Impressive gains of over 10%, however, were chalked up by both indices in November. Bolstered in part by the market response to the outcome of the elections, at end-November the NYSE Composite and the DJI Average were 81.02 and 993.34, respectively.

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Exchange Rates

The widening of interest rate differentials between U.S. rates and those of most major industrial countries was largely responsible for the strength of the dollar from end-September through November. The runup of rates on short-term issues was especially notable, with bond equivalent yields on Treasury bills and money market instruments escalating by about 375 basis points and almost 500 basis points, respectively.

The dollar gained against almost all major currencies over the period. Based on month-end quotes, the dollar depreciated about 2.2% against sterling in October but recouped this loss with a 3.3% advance in November. Appreication against the German mark, French franc, and Swiss franc was particularly sharp in October, ranging from 3.7% to 4.9%. Dollar gains were moderate in November, the sharpest being against sterling followed by 2.7% vis-à-vis the Japanese yen.

Gross Activity

Gross activity by foreign investors in U.S. equities in October rose to $8.4 billion, up 21% from the September level of $6.9 billion. Asia was the only exception to the stepped up level of activity, which ranged from 26% to 33% for the other three major geographic regions--Europe, Canada and Latin America. The 15% decline in activity by Asian countries was based mainly on a drop in activity by the oil-exporting countries to $543 million from the unusually high $705 million recorded in September.

Net Purchases

Net purchases of U.S. equities in October jumped to $518 million, compared to September's $240 million. European investors evidenced an exceptionally strong interest in U.S. equities, with net purchases totaling $300 million. Latin American investors also made significant monthly purchases of $132 million. Net purchases by Asian countries receeded to $159 million, more in-line with the historical monthly figures than the $429 million reported in September. Canadian investors stepped up their net selling to $66 million in October from $22 million in September.

The renewed enthusiasm of European investors for U.S. equities is in marked contrast to recent behavior. Third-quarter activity resulted in net purchases of only $65 million, with net sales of $83 million recorded in September. While investors in all European countries with the exception of the United Kingdom were net sellers in September, only the Belgium-Luxembourg countries and the Netherlands made net sales in October. The most significant of the turnabouts were made by Swiss and German investors. Both had been net sellers in every month of the third quarter. German investors were net sellers of $18 million of equities in September but swung

to net purchasers of $35 million in October. The Swiss made net purchases of $82 million in October, compared to substantial sales of $122 million in September.

Preliminary SIA data for November indicates that foreign investors significantly stepped up net purchases of U.S. equities. While gross activity is estimated at about the same level as in October, net purchases are projected in the $600-800 million range. In general, November data support increased interest by foreign investors. The dollar continued to evidence strength and the stock market indices registered impressive monthly gains.

TABLE 1

FOREIGN ACTIVITY IN U.S. EQUITIES

August 1980 - November 1980

I. Percent change in value of gross activity (purchase & sales)

	SIA Estimate[1]	U.S. Treasury Figure
September/August	+6	+8
October/September	+24	+23
November/October	-2	--

II. Ratio of purchases-to-sales

	SIA Estimate	U.S. Treasury Figure
August	1.14	1.05
September	1.11	1.11
October	1.15	1.13
November	1.32	---

Source: SIA Research Department, U.S. Treasury

1. Estimates are based on data from a sampling of major brokerage firms. It is important to note that these data are reported on a settlement date basis. Transactions during the last five business days in any month will be reflected in the following month's data.

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Foreign Activity

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Volume IV No. 1 March 16, 1981

FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. In 1980, both gross activity and net purchases by foreign investors of U.S. equities skyrocketed to all-time highs. Gross activity reached $75.0 billion, surpassing 1979's record $43.7 billion by 72%. Net purchases soared to $5.2 billion, topping the previous peak of $4.7 billion recorded in 1975 by 10%. Most of the strength of last year's activity derived from the first and fourth quarters, when U.S. interest rates were reaching new heights.

2. Given 1980's striking amount of gross foreign activity, the trend of foreign participation in the securities market has exceeded the growth of stock market volume. In the 1970-80 period, average daily volume on the NYSE increased by 287% from 11.6 million shares to 44.9 million shares, while gross foreign activity rose 335% from $17.2 billion to $75.0 billion.

3. Foreign net purchases of U.S. Treasury notes and bonds increased 80% to $4.9 billion in 1980 from the 1979 figure of $2.7 billion, pushing total foreign holdings up by 11% to almost $51.0 billion. The underlying support of this figure stems from the oil-exporting countries, with net purchases of $7.5 billion offsetting net selling of $1.7 billion by European countries.

4. Despite the seesawing of U.S. interest rates in 1980, gross foreign activity in U.S. corporate bonds picked up 39% to $8.2 billion from 1979's level of $5.9 billion. Moreover, net purchases at $2.8 billion were 4 times the 1979 level and over 2 times the 1978 level.

5. Just as foreign investment in U.S. equities reached record levels in 1980, so too did participation by U.S. investors in foreign markets. While gross activity increased 77% over the 1979 level, net purchases jumped by 177%. In 1980, gross activity of U.S. investors in foreign stocks registered $17.8 billion and net purchases $2.2 billion, both figures considerably above the 1979 record of $10.0 billion and $786 million, respectively.

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Overview - 1980

A multitude of factors enter into any investment decision. Predominant among these factors for foreign investment in U.S. securities is the relative strength or weakness of the dollar. The fluctuations of the dollar, in turn, are based on complex relationships involving economic, political, and other variables. One variable of increasing influence in 1980 was U.S. interest rates, whose volatile course over the year was paralleled in the foreign exchange value of the dollar.

In the first quarter of 1980, the pace of inflation in the U.S. continued unabated, escalating from an annual rate of 13.3% in 1979 to an annualized quarterly rate of 17.2%. Inflationary expectations consequently fueled a heated buildup in the demand for money and credit and an accompanying unprecedented climb of interest rates. In an attempt to curb monetary growth, the Federal Reserve initiated several credit-tightening measures in February and March. Most of the exceptional strength of the dollar over the period was derived from the sharp widening of interest rate differentials between the U.S. and other major countries. The steady rise of the dollar brought foreign net purchases in U.S. equities to a record quarterly level of $2.1 billion. Interest rate differentials, however, overshadowed underlying economic conditions which began to signal a slowdown in economic activity as the period progressed.

With the beginning of the second quarter, the contraction of economic activity in the U.S. was officially recognized as a recession and postdated to January 1980. Moreover, the economic uncertainty that accompanies any recession was intensified by the steepness of the second-quarter decline in real GNP, 9.9% at an annual rate -- a post-World War II record. As the demand for money and credit dropped off, the upsurge of interest rates was abruptly halted. By the end of June, the prime rate had plunged to 11.5% after reaching an all-time high of 20% in early April. The slack in the demand for money and credit prompted the Federal Reserve to phase-out its credit-restraint program in May and June. The rapid descent of interest rates was the major factor precipitating the dollar's fall in value. A rising stock market did little to attract foreign investors, given the weak dollar and tenuous position of the economy. While gross activity declined 32% from the first-quarter level, net purchases of U.S. equities by foreign investors plummeted 80% to $408 million, the lowest 1980 quarterly level.

The mixed performance of the U.S. economy over the summer months began to mitigate fears of a deep and prolonged recession. Nevertheless, despite the acuteness of the recessionary decline, inflationary pressures persisted albeit not at the first-quarter pace and interest rates were quick to resume an upward momentum. Near the end of the third quarter, the Federal Reserve was forced to raise the discount rate by 1% to 11% to curb the growth of the

demand for money and credit. A marked improvement in the trade and current account position of the U.S., however, lent support to the dollar. At the same time, most major European countries were wrestling with high inflation, slower economic growth, and a deterioration in their current account position. With the exception of the oil-exporting countries, foreign investors did not show much enthusiasm for U.S. equities in the third quarter. While net purchases shot up 75% to $713 million, most of this jump was based on substantial purchases of $702 million by the oil-exporting countries.

For most of the fourth quarter, the financial markets were responding to news of an economic recovery, which was earlier and more vigorous than expected, and very rapid money supply growth.1/ Fourth-quarter real GNP growth came in at the highest pace of the year, a 5% annual rate. In light of the strong growth of the money supply, the Federal Reserve lifted the discount rate twice to 13% and the prime rate once again hit, and at some banks surpassed, 20%. Thus, the resurgence of high levels of interest rates did much to firm and support the dollar.

With the position of the U.S. current account still favorable compared with the other major industrial countries, the disturbing rate of inflation remained the chief adverse factor for the U.S. economy and the dollar. In 1980, inflation ran at a 12.4% annual rate, less than 1% below the 1979 rate. However, foreign investors viewed the U.S. economy optimistically, which may have been prompted by the incoming Reagan Administration. Net purchases jumped to $1.9 billion in the fourth quarter, just a shade below the record first-quarter level of $2.1 billion.

Stock Prices

All of the major U.S. stock market indices chalked up impressive gains from year-end 1979 to year-end 1980. Both the NYSE Common Stock Index and the S&P 500 increased by almost 26%, while the DJI Average rose by about 15%. The performance of these indices was apparently a secondary consideration for foreign investors, as the rise and fall of U.S. interest rates became the focal point of investment decisions.

Comparisons of the stock price indices for the other major world exchanges indicates that the U.S. markets were not the only ones to show significant strength in 1980. On a year-end to year-end basis,2/ the largest stock price appreciation was registered

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1/ "The Financial Markets," Quarterly Review, Federal Reserve Bank of New York, Winter 1980-81, p. 27.

2/ Based on stock price data as reported in Business Conditions Digest, U.S. Department of Commerce, January 1981.

by indices for the U.K., 24.9%, and for the U.S., 23.9%. Following with gains of about half the size were stock price indices for France and Canada. In addition, boosted in large part by foreign capital inflows, stock prices in Japan rose 7.9%. An exception to the overall increase enjoyed by most world exchanges was the 2.5% decline of stock prices in Germany. Both the high interest rates in other countries and a lack of the resource-based stocks which led the global upturn contributed to this depressed trend. Despite adverse worldwide economic conditions, the generally bullish performance of stocks is attributable to the exceptionally volatile world bond markets in 1980 (which made stocks a relatively attractive investment), increased participation by major oil-exporting countries in equity markets, and a preference by private investors for capital growth over dividends.3/

Exchange Rates

Given its wide and unpredictable swings, the dollar fared well in 1980. Year-end 1979 to year-end 1980, the dollar appreciated against four of the six major currencies, with appreciation ranging from 13% against the German mark to 2% against the Canadian dollar. The eroding of Germany's current account position as well as the high interest rates in the U.S. served to progressively weaken the mark over the year. On the other hand, the Japanese yen appreciated 18% in 1980, after sinking over 21% against the dollar in 1979. Although dire consequences were predicted for the Japanese economy in the wake of the 1979 oil price increases, the Japanese were quick to implement programs adjusting to this impact, including an aggressive export policy. In addition, the dollar continued to lose ground to the British pound, depreciating 8% in 1980 compared with 8% in 1979. Despite a recession considered the most serious in Europe, high interest rates as well as the cushion of North Sea oil supported and strengthened the pound over the year.

Foreign Investment in U.S. Equities

Annual Gross Activity

In 1980, gross activity by foreign investors in U.S. equities reached $75.0 billion, outdoing 1979's record $43.7 billion by 72%. In contrast, daily average share volume on the NYSE increased by only 39% in 1979-80. Given the weight of last year's striking amount of foreign activity, the trend of foreign participation in the market has exceeded the growth of stock market volume. In the 1970-80 period, average daily volume on the NYSE increased by 287% from 11.6 million shares to 44.9 million shares, while gross foreign activity rose 335% from $17.2 billion to $75.0 billion.

3/ "The World's High-Flying Stocks," International Economic Survey, New York Times, 2/18/81, p. 23.

TABLE I

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1979		1980	
	Gross	Net	Gross	Net
Europe	$26,409	$ 217	$46,262	$3,045
Belgium-Luxembourg	1,021	(51)	1,663	(90)
France	2,887	123	4,974	479
Germany	3,279	(221)	5,309	188
Netherlands	1,493	(71)	2,263	(329)
Switzerland	9,849	(519)	17,925	307
United Kingdom	6,868	964	12,459	2,508
Canada	6,384	552	11,694	834
Latin America	4,541	(19)	7,059	147
Bermuda	1,409	21	2,707	(6)
Netherlands Antilles	1,579	(39)	1,892	39
Asia	6,056	868	9,533	1,097
Hong Kong	1,024	94	1,886	178
Japan	1,297	127	1,899	(154)
"Other Asia"*	3,394	658	5,281	1,105
Total All Countries	$43,660	$1,626	$74,960	$5,169

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Arab Emirates.

On a regional basis, the magnitude of the across-the-board surges in activity from 1979 to 1980 was dramatic, ranging from 83% for Canada to 55% for Latin America. By comparison, with the exception of an almost 50% increase from Canada, gross activity from other regions increased minimally in the 1978-79 period. Within the European region, the largest increases in activity were recorded for Switzerland and the U.K., about 82%. In Asia, the 57% jump in gross activity stemmed from a 56% acceleration in transactions by the oil-exporting countries.

Annual Net Purchases

Net purchases of U.S. equities by foreign investors soared to $5.2 billion in 1980, topping by 10% the previous peak of $4.7 billion reached in 1975. More importantly, 1980 net purchases were more than 3 times the 1979 level of $1.6 billion. Much of the strength of last year's total derives from the exceptional level of net purchases in the first and fourth quarters, when U.S. interest rates reached new heights. Fourth-quarter net purchases at $1.9 billion almost matched the first quarter's record-setting $2.1 billion.

European Investors

Net purchases by European investors in 1980 shot up to $3.0 billion, over 13 times the 1979 level of $217 million. Although there was considerable deviation by European investors from last year, U.K. investors displayed a consistent enthusiasm for U.S. equities. Net purchases by U.K. investors increased by 1.6 times the 1979 level of $2.5 billion. Dramatic turnarounds were made by both German and Swiss investors, who after making substantial net sales in 1979 became substantial net purchasers in 1980 of $188 million and $307 million of U.S. equities, respectively. Only the Belgium-Luxembourg countries and the Netherlands were net sellers in 1980, following the 1979 pattern.

The U.K. economy, although sharing many of the same recessionary problems of other European countries, is atypical in one respect. Sterling proved almost undaunted in its lofty exchange rate position in 1980. A combination of North Sea oil and high interest rates, while supporting the pound, has exacerbated the plight of British industry. Not only has the pound's position cut exports by raising prices, but high interest rates have squeezed industry profits. Unemployment has climbed at a disturbing rate in the past two years, GNP has fallen to a negative growth rate, and inflation is still at an unacceptable 15% rate albeit improved from over 20% at the beginning of the year. This depressed economic picture, coupled with the intensified polarization of the government over how to remedy it, may well have prompted investors to seek foreign outlets for investment funds. In addition, the increase in British capital flows to U.S. equities began in late 1979, when restrictions on foreign investment were phased out by the British government.

Swiss investors have been net sellers of U.S. equities in recent years, selling over $500 million in both 1978 and 1979. A different stance was taken in 1980, as Swiss investors made net purchases of $307 million. The easing of upward pressure on the franc allowed for buoyant economic growth in Switzerland in 1980. Exports progressed swiftly during the year, despite a dampening of world trade, because of the backlog of orders arising from the

depreciation of the franc.4/ With interest rates kept low to prevent a run on the franc, Swiss investors sought the high returns available on dollar-denominated assets. While the Swiss were net purchasers for the year, this was based only on their first- and fourth-quarter activity.

The German economy, almost universally accepted as the locomotive of Europe, slowed considerably in 1980 under the weight of higher priced oil. The high rates of interest in the U.S. and other countries caused massive capital outflows, thus aggravating the weakness of the mark and compounding the problem of offsetting a swelling current account deficit. In 1974, the German current account position successfully weathered the oil price shock by a sharply increased trade surplus. However, in 1979 and 1980, the deterioration in the oil and services balances has not been offset, as export growth has lagged import expansion.5/ In 1979, with a brisk economy and a strong mark, German investors were net sellers of $221 million of U.S. equities. But, in 1980, as the dollar evidenced strength and the outlook for the German economy clouded, German investors swung to net purchasers of $188 million.

Canadian Investors

Canadian investors boosted net purchases of U.S. equities by 51% in 1980 to $834 million, chiefly on the strength of heightened interest in the first and fourth quarters. The $426 million of net purchases in the fourth quarter was exceptionally large and could have been prompted by the Canadian government's plan to impose new taxes on oil and gas companies. Canadian investors may well have turned to energy-related issues of U.S. companies. Moreover, the economic outlook for Canada is closely linked to that of the U.S. economy: if the U.S. recovery proves weak, the Canadian export market will suffer and, if U.S. interest rates remain high, the Canadian government will be forced to maintain high interest rates which will hamper consumer spending and capital investment.

Asian Investors

Net purchases by Asian investors increased a moderate 26% to $1.1 billion from $868 million in 1979. As in recent years, the major portion of activity from this region originated from the oil-exporting countries. What is exceptional about the 1980 investment pattern of the oil-exporting countries is the almost 60% leap in net purchases to $1.1 billion from the average of the

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4/ Economic Outlook, OECD, December 1980, p. 119.

5/ "The German Mark," World Financial Markets, Morgan Guaranty Trust Company, October 1980, p. 6.

past two years of $700 million. The growing surplus of the oil-exporting countries may have prompted the adoption of a less conservative approach to money management. To be sure, increased purchases of U.S. Treasury notes and bonds, the traditional investment vehicle of the oil-exporting countries, were dramatic in 1980. But the large amounts invested in U.S. equities and corporate bonds in 1980 may be indicative of a new strategy. Arab investors are reportedly moving to invest more of their funds in equity and equity-related investments, and are moving away from their normal, short-term investments.6/

TABLE II

NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1980 First Quarter	1980 Second Quarter	1980 Third Quarter	1980 Fourth Quarter
Europe	$1,475	$ 352	$ 65	$1,153
Belgium-Luxembourg	(25)	33	(28)	(70)
France	155	46	60	218
Germany	62	12	(49)	163
Netherlands	(38)	(95)	(92)	(104)
Switzerland	493	(111)	(332)	257
United Kingdom	783	460	545	720
Canada	288	48	72	426
Latin America	80	29	(139)	177
Bermuda	(26)	2	14	4
Netherlands Antilles	39	21	(145)	124
Asia	257	(31)	693	178
Hong Kong	78	11	58	31
Japan	15	(76)	(66)	(27)
"Other Asia"*	162	44	702	197
Total All Countries	$2,100	$ 408	$ 713	$1,948

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Emirates.

6/ "Arab Banks Grow," Business Week, 10/6/80, p. 70.

Foreign Holdings of U.S. Treasury Notes and Bonds

Most foreign activity in U.S. Treasury notes and bonds reflects movements by central banks to moderate any pressures on their currencies vis-à-vis the dollar. Overall, foreign net purchases of Treasuries increased 80% to $4.9 billion, pushing total foreign holdings up by 11% to almost $51.0 billion. The net purchases by the oil-exporting countries more than offset the net selling of European countries.

Net sales of $1.7 billion of Treasury issues by Europe is indicative of the downward pressure on most European currencies during the year. Of particular note are the massive sales of $2.9 billion by Germany. A combination of rising energy costs and slackened exports served to chip away at Germany's current account position, bringing it to an unanticipated $15 billion deficit at year-end. In addition, the reportedly large capital outflows to dollar- and yen-denominated assets served to push the mark lower. As the German mark deteriorated steadily against the dollar and other European currencies over the year, net sales of Treasury issues were recorded in every quarter.

In contrast, Asian countries were net purchasers of $6.3 billion of Treasuries. The large $1.7 billion of net sales by Japan was based mainly on first-quarter sales of $1.5 billion, when the yen continued the depreciation set off in 1979 by the oil-price hike. However, in March, the Japanese authorities began to put in place programs to bolster the economy and support the yen. In the remaining three quarters of the year, activity by Japan dropped to more moderate levels. The oil-exporting countries, heavy purchasers of Treasuries, accounted for the bulk of Asian net purchases. After deserting this market in 1978 and 1979, these countries made substantial net purchases in 1980, $7.5 billion. With the enormous surplus of funds flowing to these countries in 1980 and the record yields available on Treasury issues, the oil-exporting countries returned to this investment vehicle. Yields on long-term government issues bounced from a high of around 12.60% in February, to a trough of 9.90% in June, and then began a gradual climb, almost reaching the February average. Treasury bill rates (bond-equivalent yields) proved much higher and more volatile over the year. The average yields on these issues peaked at 15.85% in March, sank to a low of 8.05% in May, and then proceeded to rise steadily to close the year at 14.87%.7/

7/ Yield comparisons based on data reported in World Financial Markets, Morgan Guaranty Trust Company.

TABLE III

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS
OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1979		1980	
	Net Purch.	Holdings	Net Purch.	Holdings
Europe	$4,077	$19,554	$(1,657)	$17,897
Switzerland	(312)	655	(373)	282
West Germany	2,880	9,990	(2,889)	7,101
United Kingdom	862	6,235	945	7,180
Asia	(1,683)	19,805	6,305	26,110
Japan	(353)	11,175	(1,696)	9,479
"Other Asia"	(1,019)	8,324	7,541	15,865
All Countries	$2,724	$46,067	$ 4,912	$50,979

Source: U.S. Treasury

Foreign Activity in U.S. Corporate Bonds

Despite the seesawing of U.S. interest rates in 1980, corporate bonds did not fall into disfavor with foreign investors. On the contrary, gross activity picked up 39% to $8.2 billion, and net purchases surged to 4 times the 1979 level and over 2 times the 1978 level. At $2.8 billion for the year, net purchases were lowest in the first quarter, $337 million, when investors were waiting on the sidelines for word of the peaking of interest rates. Consequently, the scramble of investors in the second quarter, particularly April, to lock-in high returns as rates plunged resulted in the largest net purchases of the year, $1.1 billion. Although net purchases moderated in the second half of 1980, the average of the last two quarters, $690 million, is substantially above the 1979 quarterly average of only $160 million.

European investors did a turnabout in 1980 and made net purchases of $588 million, compared with net sales of $68 million in 1979. Only the Belgium-Luxembourg countries maintained the net selling pattern of previous years, while the three other European countries analyzed became significant purchasers. The heightened interest of European investors in U.S. corporate bonds considerably bolstered the year-end figure. While net purchases by the oil-exporting countries at $1.9 billion was quite material, it is not unusual for these countries to account for over 50% of the yearly figure as European interest in the past has been minimal. The attention

TABLE IV

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	1979		1980	
	Net	Gross	Net	Gross
Europe	$(68)	$2,218	$ 588	$3,556
Belgium-Lux.	(61)	137	(60)	288
Germany	47	315	210	712
Switzerland	(113)	513	100	528
United Kingdom	60	990	140	1,524
"Other Asia"	507	2,095	1,873	2,937
All Countries	$688	$5,944	$2,847	$8,237

Source: U.S. Treasury

focused on U.S. corporate bonds in 1980 most likely resulted from the rates of return available during most of the year. While interest rates in most major industrial countries were also high, in few cases did they exceed the return on long-term U.S. investment.

U.S. Investor Activity in Foreign Stocks

Just as foreign investment in U.S. equities reached record levels in 1980, so too did participation by U.S. investors in foreign markets. While gross activity increased by 77% from the 1979 level, net purchases syrocketed by 177%. For 1980, gross activity registered $17.8 billion and net purchases $2.2 billion, both figures considerably above the prior year's records of $10.0 billion and $786 million, respectively. On a quarterly basis, net purchases peaked in the third quarter at $801 million before plunging about 63% to $293 million in the fourth quarter, the low for the year.

U.S. investment in stocks of companies located in Europe reached $418 million, a distinct departure from net selling of $137 million in 1979 and $333 million in 1978. The diversification of U.S. investors into foreign stocks evidences the worldwide preference for energy-related and high technology issues. Minimal interest was expressed in recent years in the stocks of companies located in the Netherlands and France. However, in 1980, net purchases of French company issues rose to $203 million from $4 million and of Dutch companies to $252 million from $81 million.

TABLE V

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1979		1980	
	Gross	Net	Gross	Net
Europe	$ 3,369	$(137)	$ 6,616	$ 418
France	650	4	1,115	203
Netherlands	231	81	478	252
Switzerland	613	(63)	1,523	25
United Kingdom	1,443	(171)	2,646	(45)
Canada	4,510	912	6,769	776
Asia	1,657	(27)	3,244	882
Japan	1,404	(24)	2,693	838
Other	480	38	1,143	103
All Countries	$10,016	$ 786	$17,772	$2,179

Source: U.S. Treasury

Despite high employment and double-digit inflation, the French franc was one of the strongest European currencies in 1980 and the effects of the oil-price increase on the economy were somewhat delayed. The Barre government has been favoring industry growth in just such areas as were in vogue with investors in 1980 -- nuclear power and high technology. The Netherlands has the attraction of a natural gas rich economy. In addition, over the past two years, the Dutch have renegotiated many natural gas export contracts to more closely align the price with that of world oil. Albeit not without emerging problems, the Dutch economy has performed better than most, the balance of payments position is relatively good, and the currency is strong.8/

8/ "Tightening the Belt," World Business Weekly, 2/9/81, p. 31.

The rush by U.S. investors to the natural-resource stocks of Canada waned over the year from high net purchases of $461 million in the first quarter to net sales of $177 million in the fourth quarter. For the year, net purchases of Canadian stocks dropped 15% to $776 million from $912 million in 1979. This decline is based on a change in investor behavior in the fourth quarter, when sales of $177 million were recorded as a result of the late-October announcement by the Canadian government of a new energy program. The new energy program, with its proposal to increase government ownership of oil and gas properties, set off fears of nationalization and takeovers which cooled investor interest.

While the most substantial investment by U.S. investors in 1979 was made in Canadian issues, in 1980 Japanese issues were sought out to the tune of $838 million. This contrasts vividly with net sales of $24 million in 1979 and massive sales of $332 million in 1978. By encouraging capital inflows and promoting exports, the Japanese were successful in offsetting part of the large balance of trade deficit. Moreover, the Japanese economy is a high technology one, a favored investment area in 1980.

TABLE VI

NET PURCHASES OF FOREIGN STOCKS
BY U.S. INVESTORS
($ Millions)

	1980 First Quarter	1980 Second Quarter	1980 Third Quarter	1980 Fourth Quarter
Europe	$129	$ 11	$102	$176
France	106	15	48	34
Netherlands	113	19	8	112
Switzerland	(34)	14	16	29
United Kingdom	(10)	(45)	38	(28)
Canada	461	217	275	(177)
Asia	49	175	427	231
Japan	20	170	421	227
Other	19	24	(3)	63
All Countries	$658	$427	$801	$293

Source: U.S. Treasury

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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume IV No. 2 April 22, 1981

FOREIGN PARTICIPATION IN THE U.S. EQUITIES MARKETS

January - February

Overview

Initial fourth-quarter GNP numbers indicated a stronger-than-expected economic pace, and much of this strength carried over to the first month of 1981. Despite some conflicting signals, January's economic news was generally upbeat. Interest rates peaked in the first week of January and declined gradually in the next five weeks. For example, the bond-equivalent yield on Treasury bills eased from 15.83% at end January to 14.80% at end of February. However, because U.S. rates still compared well with those of other countries, the downtrend had little negative effect on the dollar.

Foreign interest in U.S. equities set all-time records in 1980, with gross activity reaching $75.0 billion and net purchases hitting $5.2 billion. In the last quarter of the year, net purchases at $1.9 billion almost matched the record first-quarter level of $2.1 billion. Net purchases in the first month of 1981 indicate that foreign investors are maintaining a healthy interest in U.S. equities. At $589 million, January net purchases were up 4.8% from the December level of $562.

Market Performance

The DJI Average pushed to over 1,000 on January 6, reaching its highest level in more than four years. However, general uncertainty over the new Administration's economic program, coupled with the "sell everything" recommendation by Joseph Granville on January 8, contributed to overall weakness by the end of the month. From month-end December to month-end January, the NYSE Composite and the DJI indices declined a moderate 4.6% and 1.7%, respectively. The market strengthened a bit in February, with gains of 1.2% recorded for the NYSE Composite and 2.9% for the DJI Average.

Exchange Rates

The dollar continued to gain impressively in the first two months of 1981. The sharpest appreciations were registered from month-end December to end January, when the dollar rose over 7.5% against the French franc, Swiss franc, and German mark. Many factors

contributed to the dollar's January advance, overshadowing the receeding levels of interest rate. The release of the U.S. hostages removed one element of uncertainty, while the unfreezing of Iran's assets caused little market disruption. At the same time, developments affecting other major currencies were viewed in a pessimistic light.1/

In February, the dollar continued to rise, albeit at a less vigorous pace. While advancing 6% against the British pound, the dollar's increase vis-à-vis other currencies was more moderate and it declined slightly against the German mark. The German mark's partial recovery came about in mid-February, when the Bundesbank terminated unlimited bank access to fixed-rate credit at 9% and introduced a Lombard facility to determine rates on a day-to-day basis.

Gross Activity

Foreign gross activity in U.S. equities dipped about 23% in January from the December 1980 level. At $6.2 billion, activity for the first month of the year was somewhat below the $8.2 billion monthly average of fourth-quarter 1980. Activity slowed down in three of the four major geographic regions, with the decline ranging from 34% for Canada to 15% for the Latin American countries. Asian countries stepped up activity by about 23%, mainly because of a 56% increase in activity by the oil-exporting countries which offset decreases by other Asian countries.

Net Purchases

While gross activity waned in January, net purchases increased about 5% to $589 million from $562 million in December. This increase was due primarily to a near-doubling of net purchases by European investors from $222 million in December to $441 million in January, thereby offsetting reduced net purchases by other regions. While three major European countries had been net sellers in December, all were net buyers in January. A swing on the part of Swiss investors from net sellers of $88 million in December to net purchasers of $107 million in January accounted for much of the increase. The principal European buyers, however, continue to be the British investors. Although net purchasers have subsided from the 1980 average monthly pace of $209 million to $177 million in January, U.K. investors seem to remain firmly committed to the U.S. equity market.

Canadian interest in U.S. securities dropped off 89% in January from the December level. Net purchases of only about $26 million were recorded, compared with $229 million in December. While Canadian purchases of U.S. equities were at an unusually high level in the

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1/ "Treasury and Foreign Exchange Operations," Federal Reserve Bulletin, March, 1981.

fourth-quarter of 1980, the January level is still low by historic standards. The Canadian dollar firmed in late December and January on the drop in U.S. interest rates. However, the unresolved national energy policy remains a problem. Net purchases by Asian countries also declined in January, to $39 million from $109 billion. This 67% drop was due mainly to the oil-exporting countries, which decreased their net purchases from $177 million in December to $63 million in January.

Preliminary SIA data indicate that gross activity in and net purchases of U.S. equities by foreign investors declined moderately in February from January's levels. In February, the dollar remained firm, economic indicators continued to be mixed, and the stock market indices trended up slightly. Thus, given the lack of any significant developments to cause a substantial shift in investment patterns, net purchases by foreign investors are projected in the $250 - $450 million range in February.

TABLE I

FOREIGN ACTIVITY IN U.S. EQUITIES

January 1981 - February 1981

I. Percent change in value of gross activity (purchases & sales)

	SIA Estimate[1]	U.S. Treasury Figure
December/November	-6	+1
January/December	-23	-23
February/January	-20	---

II. Ratio of purchases-to-sales

	SIA Estimate	U.S. Treasury Figure
November	1.32	1.24
December	1.19	1.15
January	1.29	1.13
February	1.21	---

Source: SIA Research Department, U.S. Treasury

1. Estimates are based on data from a sampling of major brokerage firms. It is important to note that these data are reported on a settlement date basis. Transactions during the last five business days in any month will be reflected in the following month's data.

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FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. In 1980, gross activity by foreign investors in U.S. equities soared to a record $75.0 billion, 72% higher than the previous peak of $43.7 billion set in 1979. This year's first-quarter gross foreign activity of $18.5 billion ran only a shade below the 1980 quarterly average of $18.8 billion.

2. Net purchases of $1.7 billion in the first quarter of 1981 compare favorably with the record-setting 1980 level of $5.2 billion. On a quarterly basis, net purchases declined only 14% from the impressive $1.9 billion in the fourth quarter of last year.

3. Total foreign holdings of U.S. Treasuries increased by about 9%, or $4.4 billion, to $55.3 billion in the first quarter. European countries purchased $901 million of Treasuries in a reversal from the net selling pattern of 1980. Central banks typically operate through Treasury securities to quell pressures on their currencies vis-à-vis the dollar. While it is likely that central banks were net sellers, purchases by other investors probably offset central bank transactions.

4. As yields on long-term fixed income issues soared in the first quarter, foreign investors dramatically escalated their purchases of U.S. corporate bonds. Net purchases by foreigners almost tripled, increasing from $551 million in the fourth quarter of 1980 to $1.5 billion.

5. After peaking in the third quarter of 1980 at $801 million, U.S. investors' net purchases of foreign stocks began to wane. The trend has persisted, with net purchases in the first quarter of 1981 dropping 54% to $134 million from $293 million in the fourth quarter.

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Overview - First Quarter 1981

The direction of foreign portfolio flows hinges on investor expectations of many trends, including economic growth, fiscal and monetary policy, and political stability. One of the major variables which determines the attractiveness of assets denominated in any currency is the value of that currency itself. Fluctuations in the value of a currency typically mirror the underlying strength or weakness of an economy. In 1980, however, the marked volatility of the dollar increasingly reflected the trend of U.S. interest rates. With the level of U.S. interest rates remaining comparably high in the first quarter of 1981, the dollar appreciated against most major foreign currencies. Thus, foreign investment in U.S. equities declined only moderately from the previous quarter's impressive level.

During the first quarter of 1981, the U.S. economy expanded at a rapid annual rate of 8.4%. Despite this vigorous overall economic growth, the unemployment rate remained entrenched around the year-end level. In addition, little progress was made in containing inflation, as inflation was increasing at the end of March at an annual rate of 10.6%. The change in Administration was greeted enthusiastically, followed by general uncertainty as the government began its struggle to put a new economic program in-place.

In contrast, the economies of most major European countries remained muddled in recession. Persistent balance of payments deficits, exchange rate weakness, rising unemployment and dependence on costly imported oil was accompanied by sluggish growth. Policies to remedy this downtrend have become the subject of major political and economic debate for most European governments. To protect their currencies as well as to encourage capital inflows, these governments have been forced to follow restrictive monetary policies with accompanying high rates of interest. Moreover, swelling unemployment payments and lagging revenues from depressed economic activity have limited governments' fiscal alternatives.[1/]

Supported by high interest rates and a comfortable current account position, the U.S. dollar advanced sharply in the foreign exchange markets in the first quarter. The heftiest gain was over 7% against the Swiss franc, while the dollar appreciated about 6.5% vis-à-vis both the pound and mark. In addition, the Japanese yen lost about 4%. Only the Canadian dollar appreciated against the dollar, but by less than 1%. On a monthly basis, the dollar's gains were strongest in January.

The U.S. stock market performance indices registered minimal gains in the first quarter. The Dow Jones Industrial average climbed 4% to 1003.87 by the quarter's end, a peak not seen for eight years. Similarly, the AMEX index rose 3.3%. While all indices made their best showings in March, neither the NYSE index nor the S&P 500 fully recouped the January losses.

1/ *Continental Comment*, Continental Bank of Chicago, 2/13/81.

Foreign Investment in U.S. Equities

Quarterly Gross Activity

In 1980, gross activity by foreign investors in U.S. equities soared to a record $75.0 billion, 72% higher than the previous peak of $43.7 billion set in 1979. Although first-quarter 1981 gross foreign transactions dropped 24% from the fourth-quarter 1980 level to $18.5 billion, it ran only a shade below the 1980 quarterly average of $18.8 billion. Activity from both Europe and Canada declined by about 32% on a quarterly basis, while Latin American countries reduced gross transactions by 9%. Asia was the sole region to step up activity, with the 16% increase based on heightened activity by the oil-exporting countries. The almost 50% uptick in transactions from the oil-exporting countries offset the decline in activity from other Asian countries. On a monthly basis, gross activity surged to its highest level in March, reaching $7.3 billion.

Quarterly Net Purchases

While gross foreign activity in first-quarter 1981 receded 24% from the fourth-quarter 1980 level, net foreign purchases of U.S. equities declined only 14% from $1.9 billion to $1.7 billion. Considering that the all-time quarterly peak was $2.1 billion reached in the first quarter of 1980, foreign net purchases remained at a notable level. Activity by European countries provided the mainstay for the first-quarter level, as the three other major regions had substantial cutbacks. For Canada and Latin America, however, fourth-quarter net purchases were unusually strong, representing the high for the year. On the other hand, the 86% decline in net purchases by Asian countries, mainly the Mideast, is a distinct departure from the enthusiastic buying pattern of 1980.

European Investors

All major European countries were net purchasers of U.S. equities in the first quarter of 1981 for the first time in at least two years. At $1.3 billion, net purchases were up 13% on a quarterly basis and almost matched the record-setting first-quarter 1980 level of $1.5 billion for European investors. An interest in U.S. equities on par with the heightened level of the fourth-quarter was evidenced by French, Swiss and U.K. investors. However, German investors reduced their net purchases by 55% to $73 million from the atypical fourth-quarter pace of $164 million. In a deviation from established selling patterns, both the Belgium-Luxembourg countries and the Netherlands made net purchases of $10 million and $57 million, respectively.

U.K. investors provided the underpinnings for the level of European net purchases of U.S. equities in 1980, purchasing a substantial $2.5 billion. This significant buying trend, based partly on the late 1979 removal of exchange controls and partly on the depressed picture for British industry, continued through the first-quarter 1981. Net purchases by U.K. investors totaled $707 million, barely fluctuating from the fourth-quarter level of $720 million. Contributing to the continuation of this trend were uncertainties over the March budget

TABLE I

GROSS ACTIVITY IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1980 Fourth Quarter		1981 First Quarter	
	Gross	Net	Gross	Net
Europe	$15,609	$1,153	$10,595	$1,302
Belgium-Luxembourg	610	(70)	381	10
France	1,722	218	925	210
Germany	1,913	164	1,05?	73
Netherlands	791	(104)	568	57
Switzerland	6,153	257	4,056	227
United Kingdom	3,870	720	2,923	707
Canada	3,926	426	2,713	221
Latin America	2,213	177	2,013	92
Bermuda	778	4	808	44
Netherlands Antilles	634	124	556	85
Asia	2,652	178	3,067	25
Hong Kong	551	31	342	30
Japan	395	(27)	290	(48)
"Other Asia"*	1,561	197	2,334	42
All Countries	$24,542	$1,948	$18,534	$1,665

SOURCE: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, The United Arab Emirates.

announcement and speculation over the size of the central bank's reduction in the minimum lending rate. Moreover, the previously undaunted strength of the pound began to waiver over the first quarter, as these concerns intensified and worldwide anxieties over a shortage in oil supplies and higher prices lessened. One of the main reasons for the pound's lofty value in 1980 was Britain's energy wealth resulting from North Sea Oil and the accompanying surplus it brought to the current account position.

Just as British investors had little reason in the first quarter to alter 1980 investment behavior, neither did French or Swiss investors. Net purchases by French investors moderated about 4% from the fourth-quarter level to $210 million, while Swiss net purchases dropped around 12% to $227

million. The Swiss survived 1980 with a bouyant economy, relatively low rate of inflation, and high rate of employment. However, with the deepening of recessions in Europe and particularly Germany, the export-oriented Swiss economy has been slowing. In addition to the clouded demand outlook, interest rate differentials perpetuated a continuing slide in the value of the franc, forcing the central bank to raise its discount rate in February to 4%. In contrast to the Swiss economy, the French are struggling to combat both high inflation and unemployment. From March 1980 to March 1981, unemployment increased 17.5% and inflation ran at a 14% rate. Uncertainties over policies to restore economic vigor intensified as the national elections drew near.

German investors continued to be net purchasers of U.S. equities, albeit at a reduced level from the exceptional fourth-quarter pace. First-quarter net purchases totaled $73 million, 55% below the previous quarter's total of $164 million. However, fourth-quarter net activity represented a level not reached in at least two years. Thus, first-quarter net purchases by German investors can be considered sizable, reflecting the weighing of prospects for the U.S. economy against the depressed German outlook. The swift and deep deteriorating of Germany's economic picture was not halted in the first quarter of 1981. GNP rose at a moderate 1.8% in 1980 but is expected to decline in 1981; the current account deficit was surprisingly large in 1980 and grew in January 1981; and the German mark further eroded over the first quarter as U.S. interest rates rose. In an attempt to bolster the mark, the Bundesbank sharply increased interest rates in February.

Canadian Investors

In the first quarter of 1981, net purchases of U.S. equities by Canadian investors fell 48% to $221 million from $426 million in the fourth quarter. The stepped-up activity of the last quarter of 1980 may have reflected the flight of Canadian investors to energy-related U.S. companies in wake of the Canadian government's plans to impose new taxes on oil and gas companies. Nevertheless, first-quarter 1981 activity still represented a material interest in U.S. equities by Canadian investors. Energy policy remains the subject of heated national debate and the cause of polarization. There has been improvement in Canada's trade position, with both the relatively cheap Canadian dollar and energy giving a competitive boost to raw materials producers and to manufacturers that export much of their output.2/ In addition, the Canadian dollar recovered from its 47-year low of $0.82 against the dollar to $0.84 at the quarter's end.

2/ "Canada: A nation turns against itself and the U.S.", Business Week, 3/16/81, p.42

Mideast Investors

Mideast investors purchased a substantial $1.1 billion of U.S. equities in 1980. However, after peaking in the third quarter at $702 million, net purchases have declined dramatically, dropping to $197 million in the fourth quarter and further to only $42 million in the first-quarter 1981. While interest in equities has waned, the oil-exporting countries made massive purchases of Treasuries and corporate bonds during the first quarter.

Foreign Holdings of U.S. Treasury Notes and Bonds

U.S. Treasury notes and bonds are the main vehicles through which most central banks operate to quell pressures on their currencies vis-à-vis the dollar. In 1980, foreign holdings of Treasuries increased by $4.9 billion to $51.0 billion, as the oil-exporting countries made large net purchases that more than offset the net selling of the European countries to stem the downward pressure on their currencies. While the oil-exporting countries continued to make massive net purchases of Treasuries in the first quarter of 1981, the European countries swung from net sellers to net purchasers. Total foreign holdings of U.S. Treasuries increased by about 9%, or $4.3 billion, to $55.3 billion.

European countries were net sellers of $1.7 billion of Treasuries in 1980, with net sales of $682 million recorded in the fourth quarter. Although the dollar continued to move up in the first-quarter of 1981 against most Western European currencies, net purchases of $901 million of Treasuries were made. On a monthly basis, only in March were net sales reported for Europe, due to substantial selling of $575 million of Treasuries by West Germany. The first-quarter investment pattern by European countries would seem to contradict the basic theory that central banks sell Treasuries during periods of downward pressure on their currencies. However, while it is likely that central banks were net sellers, we believe purchases by other investors offset bank transactions. The rates of U.S. Treasuries, both short- and long-term issues, were considerably higher during most of the period than those available on similar issues offered by foreign governments. The comparative economic progress of the U.S. as well as the strengthening dollar provided an added attraction for this investment.

The sizable net purchases by Asian countries, $2.7 billion, reflects stepped-up activity by the oil-exporting countries. These countries made net purchases of $7.5 billion in 1980, compared with net sales of $1.0 billion in 1979. Yields on long-term U.S. government bonds jumped to over 13% in February-March, considerably above the yields available throughout 1980. Coinciding with the increased yields and anticipated capital gains when interest rates fall, oil-exporting countries made massive net purchases of $1.1 billion and $1.3 billion in February and March, respectively.

TABLE II

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS
OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1980 Fourth Quarter		1981 First Quarter	
	Net Purchases	Holdings	Net Purchases	Holdings
Europe	$ (682)	$17,897	$ 901	$18,798
Switzerland	(81)	282	42	324
Germany	(774)	7,101	5	7,106
United Kingdom	(276)	7,180	712	7,892
Asia	1,818	26,110	2,717	28,827
Japan	35	9,479	64	9,543
"Other Asia"	1,751	15,865	2,675	18,540
All Countries	1,544	50,979	4,343	55,322

SOURCE: U.S. Treasury

Foreign Activity in U.S. Corporate Bonds

In contrast to 1978 and 1979, foreign investors purchased impressive amounts of U.S. corporate bonds in 1980. In the first quarter of 1981, as yields on long-term issues rose, foreign investors dramatically escalated their purchases of U.S. corporate bonds. Net purchases by foreigners almost tripled, increasing from $551 million in the fourth quarter of 1980 to $1.5 billion. Gross activity also increased significantly, from $1.7 billion to $2.8 billion.

European investors were net purchasers of $542 million of U.S. corporate bonds during the first quarter of 1981, a 2-fold increase from $183 million recorded in the previous quarter. West German and British investors were particularly avid purchasers, increasing their net purchases by $143 million and $234 million, respectively. It is interesting to note that both German and U.K. investors are exempt from the U.S. withholding at the source tax on interest income. Swiss investors purchased $33 million of corporate bonds in contrast to the large purchases by other European countries. The oil-exporting countries, which purchased $1.9 billion of corporate bonds in 1980, continued to be enthusiastic purchasers, increasing net purchases to $882 million from $318 million in the prior quarter.

Short-term interest rates in the U.S. eased during the first few months of 1981, changing direction several times on mixed economic and monetary news. Long-term bond yields, almost without interruption, trended upward. To soothe investor reluctance to purchase long-term debt in an uncertain inflationary environment, corporations attempted to reduce risk and increase the marketability of new offerings by shortening maturity and offering special features.3/

On balance, yields in the U.S. corporate bond market rose by about 100 basis points over the quarter.4/ While domestic corporate bond rates rose in most European countries, the climb was at a considerably slower rate than in the U.S. Yields in the U.K. rose 14 basis points, 16 basis points in France, and 45 basis points in Switzerland. Yields on domestic corporate bonds in West Germany rose 140 basis points in the first quarter of 1981, although the pace of inflation was picking up, moderating the increase in real terms.

TABLE III

GROSS ACTIVITY AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	1980 Fourth Quarter		1981 First Quarter	
	Gross	Net Purchases	Gross	Net Purchases
Europe	$ 885	$ 183	$1,264	$ 542
Belgium-Luxembourg	54	(4)	55	(11)
Germany	112	60	279	203
Switzerland	176	22	167	33
United Kingdom	377	25	619	259
"Other Asia"	452	318	1,100	882
Total	$1,749	$ 551	$2,810	$1,494

SOURCE: U.S. Treasury

3/ Quarterly Review, Federal Reserve Bank of New York, Spring 1981, p.21

4/ Based on data as reported in World Financial Markets, Morgan Trust Company, April, 1981.

U.S. Investor Activity in Foreign Stocks

At $17.8 billion and $2.2 billion in 1980, gross activity and net purchases of foreign stocks by U.S. investors reached record levels. After peaking in the third quarter at $801 million, U.S. net purchases of foreign stocks began to wane. The trend has persisted, with net purchases in first-quarter 1981 dropping 54% to $134 million from $293 million in the fourth quarter. Gross activity also declined, falling 13% from $5.2 billion to $4.5 billion. Sharply reduced net purchases of European stocks plus large sales of Canadian stocks perpetuated the overall downtrend, as U.S. investors evidenced a marked enthusiasm for Japanese stocks.

In the first quarter, net purchases of foreign stocks of companies located in Europe declined by over 74% from $176 million to $46 million. The most dramatic swing of U.S. investors was from net purchases of $112 million of stocks of companies located in the Netherlands to net sellers of $1 million. With the lessening of concern over the energy shortage and progress made by most countries in conservation, U.S. interest in the resource companies of the Netherlands diminished. However, the 1980 quarterly data on investment in the Netherlands indicates a very erratic pattern. U.S. investment in French companies increased to $52 million from $34 million in the fourth quarter. Net purchases were based mainly on activity in the first month of the quarter, as hesitancy developed in the remaining months as the national elections approached.

Despite the modest recovery of the Canadian dollar and a somewhat brighter economic outlook, the Canadian provinces remain deeply split over energy policy. As Canadian energy-related securities were favored by U.S. investors in 1980, it is not surprising that, with the intensification of the energy policy dispute, U.S. investors escalated sales of Canadian issues from $177 million in the fourth quarter to $360 in the first quarter. On the other hand, U.S. investors stepped up net purchases of Japanese stocks to $411 million for $231 million in the fourth quarter. The most substantial U.S. foreign investment in 1980 was made in Japanese securities, $838 million, and investors still evidence a preference for the high-technology issues of that country.

Carolyn Hildebrandt
Associate Director of Research

TABLE IV

GROSS ACTIVITY IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1980 Fourth Quarter		1981 First Quarter	
	Gross	Net Purchases	Gross	Net Purchases
Europe	$2,142	$ 176	$1,466	$ 46
France	408	34	258	52
Netherlands	174	112	61	(1)
Switzerland	461	29	273	19
United Kingdom	835	(28)	737	(35)
Canada	1,676	(177)	1,204	(360)
Asia	1,015	231	1,393	411
Japan	858	227	1,022	436
Other	321	63	403	37
All Countries	$5,154	$ 293	$4,466	$ 134

SOURCE: U.S. Treasury

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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume IV No. 4 July 20, 1981

FOREIGN PARTICIPATION IN THE U.S. EQUITIES MARKETS

April - May

Overview

Following the unexpectedly strong 8.4% annualized rate of GNP growth during the first quarter of 1981, the pace of economic growth slowed considerably in April and May. The composite index of leading economic indicators rose a modest 0.4% in April and declined 1.8% in May. Nevertheless, interest rates trended upward through April and rose dramatically through most of May. The rapid expansion of the money supply in early May prompted concern that the Federal Reserve would adopt a more restrictive stance, and the banks raised their prime to 19% in anticipation. The Federal Reserve was quick to respond, raising the discount rate to a record 14% and the penalty surcharge to frequent borrowers to 4%. Subsequent increases in the prime rate brought it to above 20.5%; towards the end of the month, however, rates began to ease.

The high level of U.S. interest rates, a slight easing of inflation and a favorable current account position bolstered the dollar in foreign exchange markets. A strong currency, coupled with the improving economic picture, has maintained foreign interest in U.S. equities at a high level in 1981. Foreign net purchases rose to $744 million in April from $634 million in March, a 17% increase. If this pace of buying continues, last year's record $5.4 billion net purchases of U.S. equities by foreign investors will be surpassed.

Market Performance

The DJIA topped 1020 in mid-April, but fell off as the month progressed to close at 997.75. The first two weeks in May witnessed a 3¼% drop in the Dow, with a moderate uptick after the Memorial holiday bringing the month-end close to 991.75. The NYSE and S&P 500 Indices followed a similar pattern, declining 1.6% and 2.5%, respectively, from end-March to end-May.

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Despite the market's unexceptional performance in April-May, however, many analysts remained fairly optimistic for the longer term, projecting lower rates of interest and inflation, favorable tax policy changes and, eventually, higher equity prices.

Exchange Rates

During the past several years, the industrialized countries' relative dependence on imported oil and success in cutting oil consumption has been one of several key determinants of exchange rate movements. A high level of dependence on imported oil meant greater vulnerability to externally induced increases in oil prices and supply cutbacks. With the recent oil glut and consequent softening of oil prices, however, attention has once again turned to domestic monetary policies in projecting future exchange rate movements.

The strength of the dollar in May was based in part on the high level of U.S. interest rates, and in part on anticipated changes in fiscal and monetary policies. The deutschemark and French franc, in contrast, were under heavy pressure during May because of developments in both countries which signalled larger budget deficits and higher rates of inflation. The West German government released a revised budget estimate for 1981 in the latter part of May, showing higher-than-expected federal borrowing requirements. The projected deficit is 24% higher than the initial projection.1/ This news, coupled with West Germany's burgeoning current account deficit, pushed the deutschemark to its lowest level vis-à-vis the dollar in four years. After posting a 4.7% drop in April, the mark declined 5% in May.

Mitterand's election victory greatly weakened the French franc. The franc's precipitous decline on May 10th prompted massive intervention by the Bank of France and over 20% of France's total foreign exchange reserves, excluding gold, was drawn down.2/ Pressure on the franc stemmed from widespread belief that the French government's objectives -- reduce unemployment through expansionary monetary policies and extensive public sector job creation; raise the minimum wage 10%; expand social benefits; and, reinstate more extensive government intervention in the economy -- were certain to widen the budget deficit, further aggravate the 12-14% rate of inflation and push the currency still lower in foreign exchange markets. The French franc declined 5.2% in April and 5.6% in May vis-à-vis the dollar.

1/ "Bonn Opposition Hits Out At Budget Policy," Financial Times of London, May 28, 1981, p. 3.

2/ "The French Franc," World Financial Markets, June 1981, p.6.

The U.K. pound sterling registered a 4.3% decline against the dollar in April and 3.2% in May, mainly because of the large interest rate differential. Despite the negative effect of the oil price declines on the pound, analysts were optimistically citing a much more moderate decline in U.K. economic indicators during May as evidence that the economy had bottomed out.

Gross Activity in April

Foreign gross activity in U.S. equities in April maintained the pace set in March, about $7.3 billion. Gross activity on the part of European investors remained almost constant from March to April, both in aggregate and on a country-by-country basis. Gross activity in U.S. equities by Canadian investors rose 14%, from $1.1 billion in March to $1.3 billion in April. Japanese investors and investors domiciled in the oil-exporting countries reduced their gross activity by 15.7% and 8.2%, respectively.

Net Activity in April

Net purchases of U.S. equities by foreign investors in April increased over 17%, from $634 million in March to $744 million. The increase was accounted for by Canadian investors and Asian investors domiciled in the oil-exporting countries, as European investors' net purchases declined over 30%.

Net purchases by European investors dropped from $605 million in March to $422 million in April. Both Swiss and West German investors halved their net purchases of U.S. equities from March to April, from $138 million to $78 million, and from $31 million to $15 million, respectively. Investors domiciled in the U.K. reduced net purchases by $111 million, from $308 million in March to $197 million in April. French investors, in contrast, increased net purchases by 15% from March to April, bringing their total net purchases of U.S. equities during the first four months of 1981 to $339 million, compared to $482 million for all of 1980. The substantial increase in net purchases by French investors during 1981 -- particularly in March and April -- is partly explained by political uncertainties and the resultant French franc weakness.

Canadian investors, in contrast, stepped up net purchases of U.S. equities more than two-fold from March to April. Canadian investors' net purchases amounted to $103 million in March, rising to $230 million in April. The Canadian dollar fell 1.4% against the U.S. dollar during April and May and the longer term outlook for the currency is not rosy: inflation is running at a 12% rate, unemployment at 7%, and the federal budget deficit promises to grow larger as a result of the Government's plans to buy out 20% of the oil and gas industry presently owned by foreign investors. Furthermore, the Canadian government's tax revenues have remained fairly constant in real terms, due to cost-of-living adjustments

in exemptions, while government spending has greatly increased, in part to stem separatist pressures.3/

Similarly, investors based in oil-exporting countries, net sellers of $95 Million in March, became net purchasers of $114 million of U.S. equities in April. April's net purchase figure for investors domiciled in oil-exporting countries constituted almost three-quarters of their total net purchases of U.S. equities in the first four months of 1981.

May Projections

Preliminary SIA data indicate that gross activity in U.S. equities by foreign investors rose minimally from April to May. In aggregate, we project a modest increase in net purchases of U.S. equities by foreign investors from April to May; the ratio of purchases to sales for our sample firms rose from 1.19 to 1.38. Net purchases of U.S. equities by foreign investors are projected to range between $775-$900 million in May.

3/ "Can Canada Get Its Act Together?" Forbes, July 20, 1981.

TABLE I

FOREIGN ACTIVITY IN U.S. EQUITIES

April 1981 - May 1981

I. Percent change in value of gross activity (purchases & sales)

	SIA Estimate[1]	U.S. Treasury Figure
March/February	+43	+44
April/March	- 2	+ 1
May/April	+ 0.3	---

II. Ratio of purchases-to-sales

	SIA Estimate	U.S. Treasury Figure
February	1.21	1.18
March	1.31	1.19
April	1.19	1.22
May	1.38	---

Source: SIA Research Department, U.S. Treasury

[1] Estimates are based on data from a sampling of major brokerage firms. It is important to note that these data are reported on a settlement date basis. Transactions during the last five business days in any month will be reflected in the following month's data.

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Foreign Activity

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by the SIA Research Department

Volume IV No. 6 September 18, 1981

FOREIGN ACTIVITY IN U.S. SECURITIES

HIGHLIGHTS

1. Based on the persistent strength of the dollar and encouraging economic prospects, foreign investment in U.S. equities soared to a record $2.9 billion in the second quarter, surpassing the previous peak of $2.1 billion set in the first quarter of 1980. Gross activity picked up from the first-quarter 1981 level of $18.5 billion to $22.0 billion.

2. At $4.6 billion, net purchases for the first half of 1981 alone are close to matching the record setting 1980 level of $5.2 billion.

3. After reaching an extraordinary level of $1.5 billion in the first quarter, foreign net purchases of U.S. corporate bonds plummeted to $795 million. Net purchases by the oil-exporting countries fell 64% to $321 million. Although down from the first-quarter level, European net purchases at $419 million still represented a high level relative to earlier periods.

4. The oil-exporting countries continue to make significant net purchases of U.S. Treasury notes and bonds, attracted by the record yields available and a strong dollar. In the second quarter, net purchases of $2.8 billion were recorded compared with $2.7 billion in the first quarter.

5. Since the end of 1980, U.S. investors have adopted a cautious approach to foreign equities. Net purchases of foreign equities inched up to $164 million in the second quarter from $134 million, based mainly on the swing to net purchases of U.K. securities in contrast to net sales in the first quarter.

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Overview - Second Quarter 1981

Foreign portfolio investment decisions are governed by a complex set of factors. Predominant among these factors is the relative value of a nation's currency, for that value is a mix of a country's overall economic and political policies. With U.S. interest rates at comparably high levels in the first six months of 1981, the dollar continued to surge against all major foreign currencies. Interest rate differentials, however, were not the sole support of the dollar in the first half of 1981 as in 1980. Recovery from the 1980 recession carried over into the first quarter of 1981, and both fiscal and monetary policy developments were viewed as presaging favorable economic consequences. Based on the steady advance of the dollar and encouraging economic prospects, foreign investment in U.S. equities soared to a quarterly record. Second-quarter net purchases at $2.9 billion were 38% above the previous peak, $2.1 billion set in the first quarter of 1980.

After an unexpected show of strength in the first quarter, economic activity in the U.S. declined in the second quarter at a 2.4% annual rate. The general consensus was that the economy was entering a period of sluggish growth. Accompanying the GNP drop was a welcome slowdown in the pace of inflation, with the CPI running at an annual rate of 9.6% in June. Nevertheless, interest rates remained at or near record levels. There were a number of factors in place cushioning the effect of these high rates and auguring against a slide into recession. Among these were the boost to consumer purchasing power by falling oil prices and flat food prices, the rising dollar exchange rate, anticipation of tax cuts, and the already depressed state of the interest-rate-sensitive components of the economy, limiting somewhat their future downside potential.1/

The outlook for economic recovery in most European countries is decidedly more ambiguous than for the U.S. Buttressed by high U.S. interest rates, dollar-priced world oil has exacerbated the balance of payments positions of oil-importing nations. Abundant oil supplies and conservation measures allowed for the beginnings of a European recovery, but high U.S. interest rates have generated a "third oil price shock". The rising dollar has caused substantial capital outflows and kept the price of oil relatively high, thus stalling the European recovery. In the European countries, external constraints on monetary policies have gradually come to overshadow purely domestic economic considerations.2/

1/ The Pocket Chartroom -- Economic Research, Goldman Sachs, August 1981, p.1.

2/ OECD Economic Outlook, July 1981, p.27.

Given the lofty level of U.S. interest rates and comparably promising economic picture, the dollar appreciated significantly against most major European currencies in the second quarter. The dollar advanced 14%, 13% and 12% against the pound, French franc, and German mark, respectively. In addition, both the Swiss franc and yen fell by over 6% vis-à-vis the dollar. The Canadian dollar dropped a moderate 1%.

The lusty performance of the dollar contrasts with a faltering stock market in the second quarter. After peaking near the end of April, major stock market indices fell monthly through June. During the second quarter, both the NYSE Common Stock Index and Dow Jones Industrial Average dropped by 2.7%, while the S&P 500 was off by 3.5%. The record purchases of U.S. equities by foreign investors were clearly based on the strong dollar and future economic prospects rather than on current stock market considerations.

Foreign Investment in U.S. Equities

Quarterly Gross Activity

In the second quarter, gross activity picked up to $22.0 billion from the first quarter level of $18.5 billion. All regions stepped up activity, with the increases ranging from 23% for Canada to 14% for Latin America. Interest in U.S. equities was consistently maintained throughout the quarter, averaging about $7.3 billion monthly.

Quarterly Net Purchases

Net purchases of U.S. equities by foreign investors in the second quarter soared to a quarterly record of $2.9 billion, surpassing the previous all-time high of $2.1 billion by 38%. In comparison with the first quarter of 1981, net purchases jumped almost 75%. At $4.6 billion, net purchases for the first half of 1981 are close to reaching the record setting 1980 level of $5.2 billion. Net purchases by Asian investors climbed by almost 250% from the first quarter level, while Canadian investors stepped up net purchases by over 100%. However, the level of net purchases by both these regions in the first quarter was somewhat low compared with last year's averages. European and Latin American investors increased net purchases by 28% and 14%, respectively. On a monthly basis, net purchases peaked in May at $1.2 billion.

TABLE I

GROSS ACTIVITY IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1981 First Quarter		1981 Second Quarter	
	Gross	Net	Gross	Net
Europe	$10,595	$1,302	$12,600	$1,666
Belgium-Luxembourg	381	10	513	77
France	925	210	1,710	560
Germany	1,057	73	1,140	10
Netherlands	568	57	589	55
Switzerland	4,056	227	4,453	161
United Kingdom	2,923	707	3,751	765
Canada	2,713	221	3,344	472
Latin America	2,013	92	2,295	105
Bermuda	808	44	832	30
Netherlands Antilles	556	85	701	51
Asia	3,067	25	3,666	636
Hong Kong	342	30	420	84
Japan	290	(48)	631	189
"Other Asia"*	2,334	42	2,504	368
All Countries	$18,534	$1,665	$22,005	$2,899

SOURCE: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, The United Arab Emirates.

European Investors

For the second consecutive quarter, all major European countries were net purchasers of U.S. equities -- an unusual pattern. Net purchases by European investors rose to $1.7 billion from $1.3 billion in the first quarter. The Belgium-Luxembourg countries and France dramatically escalated net purchases, while U.K. investors increased purchases minimally from the already material levels which prevailed in the past year. On the other hand, net purchases by German investors plunged 86%, while net purchases by Swiss investors were cut back by almost 30%.

French investors showed an unprecedented enthusiasm for U.S. equities in the second quarter. Net purchases spurted to $560 million from $210 million in the previous quarter, with $392 million recorded in May alone. Economic and political turmoil ensued in the immediate wake of the election of Francois Mitterrand, France's first Socialist president in 23 years. While the quick and massive intervention of the French central bank moderated the plunge of the franc after the elections, the franc remained weak over the quarter. The need for clarification of government priorities and socialists policies kept downward pressure on the franc. Many of Mitterrand's policies have since been defined and have resulted in little relief for the franc. The plans for nationalization of major banks and industries as well as increased government spending have given rise to fears of spiralling inflation. France's inflation rate is already comparably high, around 13%, and unemployment was a troublesome 1.8 million individuals at the end of May.

British investment in U.S. equities was maintained at a substantial level in the second quarter, rising 8% from $707 million to $765 million. The removal of British exchange controls provided the initial impetus for the impressive level of British investment, but an ailing economy and an overvalued pound fueled the push. Net foreign portfolio investment by U.K. investors climbed to a record $2.3 billion during the first quarter of 1981.[3/] At the end of June, with inflation subsiding to an annual rate of 11% and improvement in several government statistics, there was speculation that the U.K. economy was turning around. However, the sharp depreciation of the pound over the second quarter, while offering some relief for Britain's export industries, complicates the implementation of monetary and fiscal policy by threatening to heat up inflationary pressures. Thus, British investors will require more conclusive evidence of a recovery before returning in force to their domestic capital markets.

Although the mark weakened considerably against the dollar in the second quarter, interest in U.S. equities by German investors waned. Net purchases dropped 86% from $73 million to $10 million. However, the investment pattern of German investors in the fourth quarter of 1980 and first quarter of 1981 was atypical, as German investors have not traditionally been avid purchasers of U.S. equities. The German economy evidenced some positive signs in the second quarter, with a small visible trade surplus in April and a sudden surge in export orders. The depreciation of the mark plus a relatively low rate of inflation should enhance Germany's competitive trade position. Swiss interest also diminished somewhat, dropping 29% to $161 million from $227 million in the second quarter. The Swiss franc was said to be the beneficiary of much of the outflow from France.

3/ "Britain's investors are exporting their cash", World Business Financial Weekly, 6/29/81, p.6

Canadian Investors

Canadian net purchases of U.S. equities jumped to $472 million in the second quarter, compared with $221 million in the first quarter. While the Canadian economy fared well in the first quarter based mainly on the surprising strength of business investment, this growth was accompanied by a troublesome exacerbation of inflation. In addition, the prospects of slowing inflation are not favorable, given the fast rising-energy prices and labor's demand for "catch-up" wage hikes. The National Energy Program called for only modest gas and oil wellhead price increases, but the imposition of indirect taxes by various levels of government has led to escalating retail prices.4/ Any resolution of the long-standing energy debate is seen as involving even higher energy prices.

Asian Investors

Net purchases by Asian investors skyrocketed in the second quarter to $636 million from $25 million in the first quarter. While over half of the total resulted from large purchases of $368 million by the oil-exporting countries, both Hong Kong and Japanese investors evidenced a substantial interest in U.S. equities. The $84 million of net purchases by Hong Kong investors is material, comparing with the previous quarterly peak of $78 million in first quarter of 1980. Japanese investors, on the other hand, had been net sellers for the past five quarters. Thus, the swing to net purchasers of $189 million is a distinct departure from previous investment behavior. Net purchases of $368 million of equities by the oil-exporting countries represent considerable enthusiasm and compares with a peak of $702 million in 1980.

Foreign Investment in U.S. Corporate Bonds

After reaching an extraordinary level of $1.5 billion in the first quarter of 1981, foreign net purchases of U.S. corporate bonds receded by 47% to $795 million. The drop-off stemmed mainly from reduced net purchases by the oil-exporting countries, from $882 million in the first quarter to $321 million. Although down 23% from the first quarter level, net purchases of $419 million by European investors still represent an atypically material level.

4/ "A recovery that still leaves millions jobless," Business Week, 8/3/8., p.49

TAPLE II

GROSS ACTIVITY AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	1981 First Quarter		1981 Second Quarter	
	Gross	Net Purchases	Gross	Net Purchases
Europe	$1,264	$ 542	$1,209	$ 419
Belgium-Luxembourg	55	(11)	43	9
Germany	279	203	315	161
Switzerland	167	33	170	72
United Kingdom	619	259	526	108
"Other Asia"	1,100	882	961	321
Total	$2,810	$1,494	$2,721	$ 795

SOURCE: U.S. Treasury

The diminished foreign interest in corporate bonds was evidenced despite yields that rose over the period and were sustained at or near record levels. Longer term rates were kept high by concerns in financial markets about implications for the economy of the proposed tax cuts and continued sizable Federal budget deficits, especially in view of the perceived determination of the Federal Reserve to hold monetary growth aggregates within targeted ranges.5/ In May, when strong demand for bank credit was evident, the Federal Reserve raised the discount rate from 13% to 14%.

The rise of the dollar over the second quarter prompted many European monetary authorities to make official statements or take actions to reassert their determination to protect their currencies. High interest rates in Europe are partly a response to the U.S. lead, but also result from the need to finance both current account and budgetary deficits and to contain inflation.6/ Thus, during the second quarter, nominal domestic corporate bond yields in most foreign countries rose steadily and by the end of the period most were above those available in the U.S.

5/ Quarterly Review, Federal Reserve Bank of New York, Summer 1981, p.35

6/ World Financial Markets, Morgan Guaranty Trust Company, 8/81.

TABLE III

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS
OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1981 First Quarter		1981 Second Quarter	
	Net Purchases	Holdings	Net Purchases	Holdings
Europe	$ 901	$18,798	$ (367)	$18,431
Switzerland	42	324	73	397
Germany	5	7,106	254	7,360
United Kingdom	712	7,892	(1,058)	6,834
Asia	2,717	28,827	3,170	31,997
Japan	64	9,543	235	9,778
"Other Asia"	2,675	18,540	2,822	21,362
All Countries	$4,343	$55,322	$2,341	$57,663

SOURCE: U.S. Treasury

Foreign Holdings of U.S. Treasury Notes and Bonds

Central banks operate mainly through U.S. Treasury securities to moderate the exchange rate movement of their currency against the dollar. Simply stated, foreign exchange markets work on supply-demand principles. When downward pressure develops on a currency vis-à-vis the dollar, central banks will most likely sell Treasuries, thereby relieving the pressure on their currency. Activity in the first quarter of 1981, however, was somewhat contradictory as European countries were net purchasers of Treasuries despite the surging dollar. We believe that most central banks were net sellers of Treasuries, but that the large purchases of other investors attempting to capture the record yields available offset central bank transactions. This pattern persisted in the second quarter, with the exception of the U.K. Total foreign holdings of Treasuries increased by $2.3 billion to $57.7 billion.

The massive sales of $1.1 billion of Treasuries by the U.K. resulted in total net sales of $367 million for Europe. Despite downward currency pressure, activity by both Switzerland and Germany cumulated in net

purchases of $73 million and $254 million, respectively. The British pound weakened moderately in the first quarter but dropped precipitously in the second. The weakening of the pound, although triggered by the reduction in the price of North Sea oil, was exacerbated by adverse interest rate differentials which prompted large capital outflows. In early June, for the first time since February 1979, the pound dropped below $2.00, a psychological barrier that once broken seemed to set off a self-perpetuating chain of further depreciation.

The oil-exporting countries continue to make substantial purchases of Treasuries, $2.8 billion in the second quarter compared with $2.7 billion in the first. The monthly net purchase pattern of the oil-exporting countries interestingly parallels returns in the government market. Yields on long-term government issues averaged over 14% in April, coinciding with massive net purchases of $1.1 billion. When yields dipped in the next two months, purchases by the oil-exporting countries, while still substantial, also declined.

U.S. Investors Activity in Foreign Stocks

Since the end of 1980, U.S. investors have adopted a markedly cautious approach to foreign equities that has been underscored by the low level of investment in the first half of 1981. Net purchase of foreign equities by U.S. investors inched up to $164 million in the second quarter from $134 million, while gross activity rose from $4.5 billion to $5.3 billion. Total net purchases for the first half of 1981 -- $298 million -- contrast with $1.1 billion for the same period in 1980. During the second quarter, the dollar maintained a dominant position in the foreign exchange market and prospects for recovery of most foreign countries became increasingly more dubious. A host of problems developed to crimp the recovery in different countries, ranging from political to economic uncertainty in light of the dollar's continued advance.

U.S. investor interest in European stocks picked up materially from $46 million in the first quarter to $112 million. However, this was based on net purchases of $18 million of U.K. securities in contrast to net sales of $35 million in the first quarter. On a monthly basis, the turnaround was made in June, just about the same time as the depreciation of the pound was thought to omen improvement in the export industry and several government statistics sent out hopeful economic signals. Net purchases of Swiss securities held steady at the first quarter pace of $19 million. U.S. investors reduced net purchases of French securities by 56% to $23 million, given the outcome of the national elections. In retrospect, as the French government is proceeding with its nationalization plans, investors' perceptions of the developing uncertainty for investment in France were well-founded.

TABLE IV

GROSS ACTIVITY IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1981 First Quarter		1981 Second Quarter	
	Gross	Net Purchases	Gross	Net Purchases
Europe	$1,466	$ 46	$1,492	$ 112
France	258	52	241	23
Netherlands	61	(1)	75	27
Switzerland	273	19	241	19
United Kingdom	737	(35)	758	18
Canada	1,204	(360)	1,397	(207)
Asia	1,393	411	1,998	232
Japan	1,022	436	1,647	185
Other	403	37	453	27
All Countries	$4,466	$ 134	$5,340	$164

SOURCE: U.S. Treasury

U.S. investors moderated net selling of Canadian securities from $360 million in the first quarter to $207 million. The net selling of Canadian securities has persisted since the fourth quarter of 1980, when the government announced its new energy program. Net purchases of Japanese securities were reduced almost 60% from the exceptionally high level of $436 million in the first quarter to $185 million. The Japanese economy has fared better than most in terms of growth and containing inflation. The basis for this growth, however, has primarily been Japan's booming export industry. Given the delayed recovery of Japan's major trading partners and the call for protectionist measures by some, economic growth may be hampered. Moreover, the yen weakened by almost 7% against the dollar over the quarter.

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Foreign Activity

AN ANALYSIS OF FOREIGN PARTICIPATION IN U. S. EQUITIES MARKETS
by the SIA Research Department

Volume IV No. 7 October 22, 1981

FOREIGN PARTICIPATION IN THE U.S. EQUITIES MARKETS

July - August

Overview

Economic activity in the U.S. dropped at a 0.6% annual rate in the third quarter and further slowing is expected in the fourth quarter. In early July, the downtrend in economic activity coupled with moderating inflation gave rise to expectations of a peaking of U.S. interest rates. However, with a restrictive monetary policy and strong credit demands, interest rates had little room to recede from record levels. In the June-July period, both short- and long-term rates moved up, with some short-term rates increasing by over 50 basis points while corporate bond rates increased by over 100 points. In August, certain short-term rates fell minimally but long-term rates continued to trend upward.

The passage of the Economic Recovery Act of 1981 did little to soothe investors' fears. In fact, investors' reluctance intensified since July, in light of prolonged high interest rates and revised estimates of the growing federal deficit. Not even the notable performace of the dollar, espècially in July, was enough to offset foreign investors' perception of clouding U.S. economic prospects and deteriorating stock market conditions. After purchasing a record $2.9 billion of U.S. equities in the second quarter, foreign investors sharply reduced their net purchases to $190 million in July. SIA preliminary data indicate that foreign investors continued to approach U.S. equities with caution in August.

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Exchange Rates

In early July, with the buildup of expectations that U.S. interest rates were easing, the dollar began to fluctuate more irregularly than before.[1/] However, when it became evident that rates were not peaking, the dollar advanced impressively against all major currencies. By the close of the month, the dollar's appreciation ranged from 5.7% against the yen to 2.6% against the French franc. The Canadian dollar continued to depreciate vis-à-vis the dollar, 2.7%,and stood at a 48-year low at month-end. The drop was precipitated by high U.S. rates as well as the outflow of funds to finance Canadian acquisitions in the U.S. The Canadian dollar, however, recovered all of its July loss by the end of August as interest rates in that nation moved decisively upward.

Signs of dollar weakness began to emerge in August. While the dollar held firm against most major currencies, it depreciated vis-à-vis the Canadian dollar and the yen. Although rumors of an EMS realignment prompted some outflow from the dollar into the mark during August, it is apparent that some of the favorable factors supporting the dollar in the past months are becoming less potent. These include: definite signs of improvement in the current account positions of both Germany and Japan, a perception that U.S. monetary policy has eased, and doubts about the feasibility of the Administration's economic recovery program given persistent high interest rates amidst a weakening economy.[2/]

Gross Activity

Gross activity of foreign investors in U.S. equities in July fell off about 14% to $6.9 billion from $7.8 billion in June. In addition, July activity ran 9% below the second quarter's average monthly pace of $7.3 billion. Asian investors cutback on gross activity by a sharp 42%, while European investors moderated activity by 8%.

Net Purchases

Representing the lowest monthly level in 1981, net purchases of U.S. equities by foreign investors dropped a precipitous 80% to $190 million in July from $937 million in June. The disenchantment with U.S. equities touched all regions. Latin American investors swung from net purchasers of $126 million in June to net sellers of $127 million in July. Most pronounced, however, was the 77% falloff in net purchases by European investors. Moreover, net purchases by Canadian and Asian investors dropped by 27% and 35%, respectively.

1/ "Treasury and Federal Reserve Operations," Federal Reserve Bulletin, September 1981.

2/ World Financial Markets, Morgan Guaranty Trust Company, September 1981.

Net purchases by European investors declined sharply to $111 million in July from $477 million in June. The enthusiasm of U.K. investors for U.S. equities considerably boosted the level of European activity in the first half of 1981, with U.K. net purchases averaging about $245 million monthly. In July, however, net purchases by U.K. investors slid to $139 million, the lowest 1981 level. British industry seemed poised for a recovery, based on the depreciation of sterling and the trimming in costs, labor and inventory necessitated by the deep recession. But, with the dropping of sterling below the $2 barrier, came rumor of the reinstating of exchange controls as well as hikes in the U.K. lending rate. Hesitant British investors had developments on both the U.S. and domestic scene to weigh. On the other hand, the French franc stabilized over the period, albeit at a low level after plummeting in May. The settling of the franc as well as a clearer definition of government policies calmed investors' fears. After spurting to a record $392 million in May, French investment in U.S. equities receded to slightly more than $40 million in both June and July. Adding to the downtrend, German, Swiss and Dutch investors made net sales ranging from $41 million to $19 million.

At $76 million, net purchases by Canadian investors were about 35% below June's level of $104 million. Asian investors also cutback net purchases from $220 million in June to $142 million in July. While net purchases by oil-exporting countries more than tripled, from $33 million in June to $106 million in July, this increase was offset by reduced net purchases by both Hong Kong and Japan.

Based on preliminary SIA data, foreign investors continued to regard U.S. equities with relative disinterest in August. Indeed, there were little developments of a domestic or international nature which would have caused any dramatic swing in investment behavior. Gross activity is projected at or slightly below July's $6.7 billion level, while net purchases appear to have inched up minimally. We estimate that net purchases in August will fall in the $225-to-$335 million range.

Table I

FOREIGN ACTIVITY IN U.S. EQUITIES

July 1981 - August 1981

I. Percent change in value of gross activity (purchases & sales)

	SIA Estimate[1]	U.S. Treasury Figure
May/April	+ 0.3	- 5
June/May	+17	+12
July/June	-16	-14
August/July	- 1	----

II. Ratio of purchases-to-sales

	SIA Estimate	U.S. Treasury Figure
April	1.19	1.23
May	1.38	1.43
June	1.24	1.27
July	1.01	1.06
August	1.06	----

SOURCE: SIA Research Department, U.S. Treasury

[1] Estimates are based on data from a sampling of major brokerage firms. It is important to note that these data are reported on a settlement basis. Transactions during the last five business days in any month will be reflected in the following month's data.

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